OPEN MEETING AGENDA ITEM

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BEFORE THE ARIZONA CORPORATION COMMISSION

ORIGINAL

COMMISSIONERS

BOB STUMP, CHAIRMAN
GARY PIERCE
BRENDA BURNS
SUSAN BITTER SMITH
BOB BURNS

IN THE MATTER OF THE APPLICATION OF SANDARIO WATER COMPANY, INC. FOR APPROVAL OF A RATE INCREASE IN THE MATTER OF THE APPLICATION OF SANDARIO WATER COMPANY, INC. FOR AUTHORITY TO INCUR LONG-TERM DEBT.	DOCKET NO. W-01831A-12-0392 DOCKET NO. W-01831A-12-0467 **COMMENTS TO THE RECOMMENDED ORDER**

The Sandario Water Company (Sandario or Company) hereby files its comments to the Recommended Order for Arizona Corporation Commission (Commission) consideration.

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1.0 Revenue Requirement

As a compromise, Sandario requests that the Commission adopt Staff's revenue requirement of $164,760. The revenue requirements proposed by Staff and Sandario are very similar – Staff, $164,760; Sandario $170,260 – a difference of only $5,500. *See* Recommended Order at p. 12, ¶ 54 & 55.

Throughout the proceeding Sandario supported its proposed revenue requirement, but believed that Staff's proposed revenue requirement was reasonable. Put another way, Sandario prefers its number, but the Company can live with Staff's proposal. Accordingly, Sandario compromised on other monetary issues. For example, Sandario met with Staff and agreed to Staff's position on income tax recovery – a compromise of $10,643. Sandario also agreed not to include the DSRF in the WIFA Surcharge – another compromise costing the Company up to $8,892.

With these compromises amounting to nearly $20,000, and knowing there was a difference of only $5,500 in the revenue requirement, Sandario believed there was no need for a hearing. *See id.* at p. 4, ¶ 21. By doing so, the Company thought it was following two Commission policies: (1) settle material disputes when possible; and (2) reduce rate case expense by avoiding a hearing. Had the Company any notice that a revenue requirement below what Staff proposed was being considered, it would have sought a hearing. The reason is simple: Staff's revenue requirement of $164,760 leaves Sandario in a manageable position financially, but coupled with the obligation to pay the DSRF from revenues, any materially lower amount leaves the Company in a very poor financial position.

But the Recommended Order's outcome, reducing the revenue requirement from Staff's position by another $16,974 to $147,786, places the Company in such a situation. Adopting such a recommendation far below the range being contemplated by all of the parties will discourage companies from resolving issues that can be settled and will force companies to insist upon hearings. This approach will assuredly add cost and expense to rate cases.

Therefore, the Company urges the Commission to adopt a revenue requirement that was within the range being contemplated by the parties at the time they resolved most of the issues – Staff's position of $164,760.

2.0 Facts Do Not Support Reducing Revenue Requirement

The Recommended Order rationalizes the reduction in revenue requirement based upon the notion that the owner has made "minimal investment" in the Company. *See, e.g.*, p. 12, ¶ 57. This is simply not true. In the 10 years prior to the Test Year, the Company's owner invested $226,425 in utility plant.[1] For a Class D utility, this is a significant, not minimal, investment.

Rather than noting the amount actually invested, the Recommended Order presumes there has been minimal investment because the Company's rate base is negative.[2] *See id.* at p. 12, ¶ 57. Yet, Sandario's owner has invested $226,425 over the past decade. So on its face, the assumption applied here is demonstratively flawed.

Further, generally speaking, negative rate base is not the outcome of minimal owner investment. If owner investment was the only factor when calculating rate base, then logically rate base could never fall below zero; it could never become negative. Rate base instead becomes negative due to the accounting treatment of AIAC. Typically, what happens is that developers make large investments in utility plant to serve their developments. This is consistent with the statewide policy that "development should pay for itself". For the first 10 years, these large investments are treated as AIAC and do not

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[1] Plant additions from 2003 to the end of the test year amounted to $235,743. During that same period, AIAC and CIAC additions amounted to only $9,318. Thus, the owner invested $226,425. *See* Application at p. 13, 24, & 25.

[2] While Staff applied a methodology resulting in a negative rate base, the Company asserts the rate base is positive.

amortize. Meanwhile, the plant depreciates. In year 11, the plant converts to CIAC and only then does the CIAC begin to amortize, beginning at 100% value of the original investment. This accounting treatment creates a mismatch between depreciation and amortization of the same plant, which drives down rate base. Hence, negative rate base does not indicate minimal utility investment; rather, it indicates very large investments by developers. The problem is exasperated by an accounting treatment that purposely mismatches depreciation and amortization of plant to suppress rate base, thereby reducing customer rates.

Sandario understands that this rate case is probably not the forum in which the Commission will investigate and review the accounting treatment of AIAC, CIAC, and the negative rate base problem. But the Company noted the issue to add clarity as to why so many small utilities have negative rate bases. Sandario sought to offer a solution while dispelling the incorrect assumption that the utility owners are primarily responsible for negative rate base. This case illustrates the commonly-held perception is not based upon the facts as known here. In truth, Sandario has made substantial investments in plant, but its rate base is negative because local developers made much larger investments that were treated as AIAC and did not generate much revenue for Sandario. Coupled with the accounting mismatch treatment, the Company's rate base slid into negative territory. The Company should not have its revenues reduced for this reason.

3.0 Rate Design

As the Recommended Order points out, the rate design should provide a stable revenue stream. *See id.* at p. 15, ¶ 66-67. Sandario agrees with the Recommended Order's proposed rate design approach, which generates 49% of the revenue from the monthly use charge and 51% from the commodity charges. Applying this rate design to Staff's revenue requirement results in the following:

MONTHLY USAGE CHARGES

All Classes	
5/8 x 3/4 - Inch Meter	$19.04
3/4 - Inch Meter	29.12
1 - Inch Meter	48.16
1 1/2 - Inch Meter	95.20
2 - Inch Meter	152.32
3 - Inch Meter	30.64
4 - Inch Meter	476.00
6 - Inch Meter	952.00

COMMODITY CHARGE

(Per 1,000 gallons, All Classes)

All Meter Sizes	
0 to 3,000 Gallons	$1.22
3,001 to 10,000 Gallons	2.50
Over 10,000 Gallons	3.05
Bulk Water (No Minimum):	$3.05

The Company asserts this rate design is reasonable and should be adopted.

Best Management Practices

The Recommended Order does not require the Company to adopt additional BMPs. *See id.* at ¶ 77. Sandario agrees with this decision. As noted in the Recommended Order, Sandario is within the Tucson Active Management Area, and therefore, is already subject to the BMP program administered by the Arizona Department of Water Resources.

RESPECTFULLY SUBMITTED this 2nd day of April, 2014.

MOYES SELLERS & HENDRICKS LTD.

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